



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-3873
PHONE: (213) 974-8301 FAX: (213) 626-5427

WENDY L. WATANABE
AUDITOR-CONTROLLER

ASST. AUDITOR-CONTROLLERS

ROBERT A. DAVIS
JOHN NAIMO
JUDI E. THOMAS

April 15, 2011

TO: All Department Heads

FROM: Wendy L. Watanabe
Auditor-Controller

A handwritten signature in blue ink, reading "Wendy L. Watanabe", is written over the printed name and title.

SUBJECT: **CONTROLS OVER DEPARTMENTAL TRUST FUNDS, REVOLVING FUNDS, COMMITMENT ENCUMBRANCES AND ACCOUNTS PAYABLE**

As part of our ongoing responsibility to ensure the County's resources are safeguarded and that departments comply with County fiscal policies and procedures, we have completed reviews of controls over trust funds, revolving funds, commitment encumbrances and accounts payable at a number of County departments. Our reviews were intended to ensure that the departments are controlling and using the funds, commitment encumbrances and accounts payable in compliance with the County Fiscal Manual (CFM) and other requirements.

Our reviews have identified some common issues in departments' controls and use of trust funds, revolving funds, commitment encumbrances and payables. At the request of the Audit Committee, we are sending this memo to all County departments so they can take action to address the issues identified in our audits. Please review the issues discussed in this memo, and ensure that appropriate controls are in place in these areas.

Summary of Control Issues

Trust Funds

Trust funds are monies received by the County, and held as a trustee, custodian or agent for other parties or jurisdictions. These funds include donations to the County, sales tax collections to be sent to the State, County clients' personal funds, and advances (e.g., grant awards) to the County that can be transferred to revenue when they have been earned. Departments are required to maintain proper accounting,

reporting and security over their trust funds. The following are areas where the departments we reviewed needed to improve controls over their trust funds:

- **Ensure that grant awards and other funds that are received in advance and placed in trust are transferred to the County as revenue in a timely manner when they have been earned.** We noted that some departments did not transfer funds to revenue after they had been earned. Keeping money in trust that should be transferred to revenue understates the County's available fund balance.
- **Review trust fund activity and close inactive/unneeded funds.** We noted a number of open trust funds that had not had any activity in several years. Keeping inactive/unused trust funds open may understate the County's available fund balance, and increases the risk of unused funds being misappropriated without detection.
- **Transfer unclaimed funds held in trust (e.g., clients' personal funds) to the Treasurer and Tax Collector (TTC) for disposition, as required by State law.**
- **Keep documentation of each trust fund's purpose and authority.** When departments do not have this information, they cannot ensure that the trust funds are used for their intended purpose.
- **Maintain detailed trust account ledgers, and prepare, review and approve trust fund reconciliations as required by CFM Section 2.3.0.** Failure to maintain ledgers and properly reconcile trust accounts can allow overages/shortages and other errors to occur without being detected.

Revolving Funds and Revolving Cash Trust Funds

Revolving funds are small cash funds and checking accounts used to make change, petty cash purchases and other purposes. Revolving cash trust funds are small cash funds and checking accounts used to make high volume refunds of money held in trust (e.g., clients' personal funds). Our review of departments' revolving funds and revolving cash trust funds disclosed the following areas for improvement:

- **Periodically review all revolving funds and revolving cash trust funds, and reduce or close any funds that are no longer needed.** If a revolving fund does not need to be replenished on at least a monthly basis, the amount of the fund may be larger than needed. Keeping excessive funds may increase the risk of loss.

- **Reconcile revolving funds and revolving cash trust fund bank accounts monthly.** We noted instances where departments did not reconcile the accounts, completed the reconciliations late, and/or did not document when the reconciliations were completed or reviewed. Failure to reconcile these accounts as required can allow overages/shortages and other errors to occur without being detected.
- **Ensure that revolving funds are not used to make petty cash purchases that should be made through the normal County procurement process.** Using petty cash for purchases that should be made through the normal procurement process is a violation of County purchasing rules.

Commitment Encumbrances and Accounts Payable

At the end of each fiscal year, County departments establish commitment encumbrances to pay for services and supplies that have been ordered or contracted for, but were not received before the June 30th fiscal year end. Departments also establish accounts payable for services and supplies that were received on or before June 30th, but will be paid for in the subsequent year. Because commitment encumbrances and accounts payable are estimates of future expenditures that restrict the County's available fund balance, departments should ensure that the amount of the commitments/payables are as accurate as possible when they are established, and that they cancel commitment encumbrances when they are no longer needed. Cancelled commitment encumbrances and unneeded payables are returned to the County's available fund balance, so they may be budgeted for future spending. We noted the following areas for improvement in the departments we reviewed:

- **Ensure that unneeded commitment encumbrances are cancelled.** We noted that some departments carry unneeded commitment encumbrances over from prior fiscal years, including some that should have been cancelled years earlier.
- **Ensure that accounts payable are established for services and supplies that are received on or before June 30th.** We noted that some departments made payments for services and supplies that were actually received before June 30th using commitment encumbrances. As noted earlier, commitment encumbrances should only be used for items that have been ordered, but have not been received by June 30th.
- **Estimate the amount of accounts payable accurately.** Our review disclosed that some departments did not use up to 71% of the accounts payable they established in some years. Overestimating accounts payable inaccurately reduces the County's available fund balance.

All Department Heads

April 15, 2011

Page 4

- **Ensure that services and supplies purchases are charged to the correct fiscal year.** We noted instances where departments charged current year purchases to encumbrance commitments and accounts payable from the prior year. We also noted prior year purchases that were charged to current year appropriations. These practices overstate the County's prior year expenses, and understate current year expenses.

Thank you for your attention to these important internal control issues. Auditor-Controller staff will continue to work with County departments and to review departmental controls in these areas.

Please call me if you have any questions, or your staff may contact Robert Campbell at (213) 253-0199.

WLW:JLS:RGC:mwm

c: William T Fujioka, Chief Executive Officer
Audit Committee